

The top of the page features a decorative header with various financial symbols and numbers in shades of blue and orange. Visible elements include a percentage sign (%), a dollar sign (\$), and numbers such as 64, 5, 9, 27, 9, 4, 10, 3, 28, and 9.

Financial Terms For Beginners



New to the world of business finances?

Financial language is often unfamiliar and confusing, making even the simplest concepts seem complex. That's why we've rounded up a list of basic financial definitions that will help you learn to read company financial statements and better understand the business you work for.

We're keeping it simple and fun by using a lemonade stand to understand what these financial terms really mean. Ready to dive in? Here are the most common financial terms you should learn to boost your business IQ.

Revenue / Sales:

This is the pure dollar amount a business takes in in a given period of time — the amount of money earned before subtracting expenses.

🍋 If you sell 100 glasses of lemonade in a month at \$1 per glass, your monthly revenue is \$100. But don't get too excited, there are still a few things you need to subtract from that \$100 in order to keep your books in order.

COGS:

COGS or "Cost of Goods Sold" is the amount of money spent on the materials and labor used to produce goods or services. COGS is subtracted from revenue to measure a business' gross profit.

🍋 Your lemonade stand's cost of goods sold might include sugar, lemons, and cups. In order to measure your stand's gross profit, you must subtract the cost of goods sold (COGS) from your revenue.

Let's say, in order to make 100 glasses of lemonade, you need:

50 lemons at \$.25 each = \$12.50

100 cups at \$.10 each = \$10.00

25 cups of sugar at \$.15 each = \$3.75

Your COGS would equal: \$26.25

Gross profit:

Gross profit is the amount of money a business earns in a given period minus the cost of goods sold (COGS).

🍋 Let's calculate your lemonade stand's gross profit!

When you subtract COGS (\$26.25) from your revenue (\$100), you get your Gross Profit: \$73.75



Bottom Line / net profit:

The “bottom line” refers to the last line of a business’ balance sheet: the net profit. This number shows the total amount of money a business has earned in a month once expenses and COGS have been taken out.

🍋 Remember your gross profit of \$73.75? Now it’s time to subtract expenses from that number to calculate your lemonade stand’s net profit.

Let’s say your expenses include:

- Paying your neighbor to help you at the stand: \$20/month
- Posters you hang around your neighborhood to advertise your stand: \$5/month
- A wagon you bought with a credit card: Monthly payments of \$5

Add those up and you’ll get your expenses: \$30/month

If we subtract \$30 per month from your gross profit of \$73.75, we get your lemonade stand’s net profit: \$43.75.

Challenge: Can you figure out how many glasses of lemonade you need to sell in order to make \$1 in net profit?

Answer: Even though you sell each glass of lemonade for \$1, you need to sell 2.3 glasses of lemonade to take home \$1 in net profit.

Gross Margin:

Gross margin is determined by subtracting the cost of goods sold (COGS) from your revenue and dividing that number by your revenue. The resulting percentage shows how valuable a sale is.

🍋 For your lemonade stand, your gross margin is 73%, meaning that 73% of every dollar you make is gross profit (note: not net profit).

Challenge: What changes could you make in your business to increase your gross margin?

Answer: Raise your prices, find better deals on sugar, lemons, or cups, or transfer your wagon loan to a credit card with lower interest rates.



Income Statement:

An income statement (also known as a Profit and Loss statement or “P&L”) shows a business’ revenue and expenses *over a period of time*.

🍋 The income statement for your lemonade stand would show what you spent, what you earned, and whether you made or lost money that month. In our lemonade stand example, this month’s income statement would show a net profit of \$43.75. Yay!

Balance Sheet:

A balance sheet gives a snapshot of a business’ financial status *at a given time*. Balance sheets include assets and liabilities.

🍋 Your lemonade stand’s balance sheet would show assets like the wooden stand you built and your cash register. It would also show liabilities like the wagon you’re making monthly payments on. If someone were looking to buy your lemonade stand business, they’d want to look at your balance sheet to determine how financially healthy your business is and if your assets outweigh your liabilities.

Cash Flow:

Cash flow is the movement or flow of money in and out of a business during a specific period of time (usually a month). A business’ cash flow is measured by comparing its available cash at the beginning and end of the month. “Cash flow positive” means the amount of cash coming into the business was greater than the amount of money going out of the business.

🍋 For your lemonade stand business, you might wait to buy more lemons and sugar after your busiest day of the week when you know you’ll have the most cash on hand. It doesn’t mean you were profitable, it just means you carefully managed when money was flowing in and out of your business.

Accounts Receivable:

Accounts receivable is money owed to a company.

🍋 For this example, let’s add a new promotion for your lemonade stand! Let’s say you offer customers the ability to pay a flat monthly rate for unlimited lemonade from your stand. Your accounts receivable would include those monthly payments from customers.



Accounts Payable:

Accounts payable is money a business owes to its creditors.

🍋 Your lemonade stand business is getting sophisticated! For this example, let's say you have a deal with a local market to have all of your lemons delivered fresh daily and the market sends you a bill each month. Your accounts payable would include your monthly lemon bill and the payments you're making for your wagon.

You did it!

You've learned the basics of business finances, and you've got the blueprint for the savviest lemonade stand ever. More importantly, knowledge is power — now that you understand what it takes to have a financially successful business, you can do your part to impact it.

Visit smallgiants.org for more leadership development resources.